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The Expansion Goes On

Japan has found itself in the unaccustomed position of collecting accolades from its trading partners for its strong economic performance. An Organization for Economic Cooperation and Development panel reports the Japanese economy is sound and that at least in the medium term its growth will continue. The statement contrasted sharply with the group's report in September 1986, which had painted a dark picture.

After hitting bottom in late 1986 or early 1987, the economy has been expanding briskly, as domestic demand-led growth pulls in more imports. In 1987 inflation-adjusted growth hit 4.2 percent (see JEI Report No. 12B, March 25, 1988), and with a third of 1988 now history, this year is already shaping up as another good one. Industrial output figures, for example, continue a pattern of strong growth, as shown in the Table below. Spending by worker households, previously something of a laggard, has shown signs of picking up. The ratio of job openings to job applications stood at a seasonally adjusted 0.90 in March,

continuing an unbroken pattern of month-to-month improvements that began last June. Department store sales rose 5.4 percent in March over the year before, roughly in line with other recent months. New automobile registrations totaled a preliminary 299,000 for March, a 12.9 percent jump compared to the year-earlier figure.

Japan's Economic Indicators

(percent change from previous period)

	Industrial Output*	Housing Starts	Expenditures of Worker Households
1986	0.2%	10.4%	1.4%
1987	3.0	22.7	0.8
January 1988	9.2	19.0	2.6
February 1988	12.4	17.1	5.0
March 1988	11.0**	14.8	n.a.

*Monthly industrial output data are not seasonally adjusted.
**Preliminary

Sources: Ministry of International Trade and Industry, Ministry of Construction, and Management and Coordination Agency.

At least one economic signal is flashing amber, however. The leading series of the diffusion index, broadly comparable to the leading indicators in the United States and intended to forecast short-term trends, dropped to 50.0 in February, exactly the dividing line between boom and bust and the lowest level in more than a year. It had stood at 72.7 the month before. The Economic Planning Agency cautioned against reading too much into a single month's figure. Indeed, most other indicators, such as corporate investment plans, point to continued growth.

Douglas Ostrom

Japanese Firms Move To Diversify

Nippon Kokan K.K., one of Japan's largest steel companies, is looking beyond its smokestacks. By 1990 it hopes to use biotechnology to develop new additives that will be used in a wide range of products from livestock feed to health foods. Its bigger rival, Nippon Steel Corp., is selling U.S.-made super-minicomputers in Japan and is planning to build and operate theme parks in provincial cities. So far these and similar ventures are miniscule compared to their steel operations, but the companies have high hopes that at least a few will become corporate mainstays. Some steel firms are even reported to be trying their hands at raising mushrooms and tulips.

While executives and the rank and file are reportedly said to prefer blast furnaces to gardening, the steel makers have little choice but to diversify. Along with a number of other industries they face a combination of tough

export markets arising from the high yen, and hard-charging rivals, particularly in the newly industrializing countries. As a result the steel industry is looking for opportunities where it can find them.

Japan's Fair Trade Commission has documented this trend in a study of 156 major Japanese manufacturers. As the Table shows, with few exceptions the companies are increasingly venturing outside their "home industry" in search of new business opportunities.

Share of Sales in Home Industry

(percentage in each fiscal year)

Home Industry	FY 1979	FY 1984	FY 1986
Food	96.1%	96.8%	97.0%
Textiles	66.3	60.3	57.1
Wood and Wood Products	86.1	72.8	68.8
Pulp and Paper	86.1	93.0	92.5
Printing and Publishing	99.9	100.0	88.3
Chemicals	88.4	88.7	84.6
Coal and Petroleum Products	99.2	99.7	99.2
Rubber	90.0	89.6	88.5
Nonmetallic Mineral Products	75.6	76.4	71.4
Steel	85.8	81.8	78.6
Nonferrous Metals	89.1	67.7	60.8
Fabricated Metal Products	91.5	90.9	90.0
Nonelectric Machinery	75.9	77.9	73.1
Electric Machinery	93.3	95.3	83.6
Transportion Equipment	79.4	77.0	79.0
Precision Equipment	59.1	45.1	37.6
Other Manufacturing	71.0	69.7	67.4
Average	86.7	84.5	80.2

Source: Japan Fair Trade Commission

While the trend seems to have accelerated since the appreciation of the yen that began in early 1985, it was apparent even earlier, as a comparison of FY 1979 and FY 1984 reveals. To some extent the data may overstate the actual rate of change as industrial boundaries have changed and new industries, each drawing firms from several old industries, have emerged.

The Fair Trade Commission could not be happier at these developments. It sees benefits for competition as more firms enter each industry and is convinced that diversification will speed the reallocation of resources away from declining industries. More generally, the FTC sees this corporate activity as a means toward the important objective of speeding up the structural transformation of the economy, a move in keeping with the goals outlined in the Maekawa Report. In addition, for many firms, diversification has taken the form of setting up import divisions or joint ventures with foreign companies, both of which serve to internationalize Japan's economy.

If a fair portion of these ventures prove successful, Japanese industry might live more happily with an ever-strengthening yen. Firms will realize that export markets can be replaced with revenues from either new ventures or increased importing. When demand declines in an industry, businesses will more easily shift employees to other activities.

Some veteran American observers may look at the Japanese efforts with a certain amount of deja vu. In the 1960s and 1970s, U.S. firms aggressively pursued opportunities in different industries, frequently by merger. The advantages of the conglomerates that resulted often proved illusory; today many are being dismembered, sometimes the victims of less-diversified Japanese rivals.

Of course Japan of the 1980s is not America of the 1970s. Most of the Japanese firms are starting new ventures, not buying existing operations, and they see their moves partly as a way of productively using their existing workforce. Often the new efforts are closer to their existing lines of business than they look at first; Nippon Kokan's biotechnology venture uses by-products of the steel smelting process, and other companies are marketing computer software they developed for internal purposes in conjunction with imported hardware. Still others use their existing marketing teams to sell the new products.

Can Japanese steel makers do a better job of running theme parks than American oil companies did at running department stores? Not everyone is convinced. Some expect that Japanese firms will increasingly resort to mergers, and become familiar with the problems of integrating ongoing operations that have often bedeviled American concerns.

A survey by the magazine Nikkei Business reveals some problems already. Of 809 new projects launched since 1981 by 149 firms surveyed last year, 72 percent were unprofitable or had already been abandoned. Part of the problem was that many firms identified the same areas as promising, resulting in overcrowding. Poor marketing was another difficulty.

No doubt many of the recently announced projects will fail -- the fate of many business ventures everywhere. If enough succeed, Japanese workers and management will both feel more confident about coping with rapidly changing circumstances, including successful foreign penetration of their traditional domestic markets. That is a change many Americans would welcome.

Douglas Ostrom

Japanese Investment Income Tops World

For the first time Japan's net income from dividends and interest on foreign investment in 1987 surpassed the net receipts of the United States, making Japan the world's leading investment income earner as well as top creditor. The yen's appreciation against the dollar helped Japan attain the top position but was not the main cause. The strong growth of government receipts gets credit for most of the change, although returns to private investors on direct investments and interest income also contributed a significant share.

Japan's total 1987 net investment income jumped a whopping 75.8 percent to $16.7 billion, compared with a 30.5 percent drop in U.S. net receipts to $14.5 billion. According to Bank of Japan data (see Table), direct investment and loan interest income showed solid growth, but only accounted for about 12 percent of the surplus. The remainder has been attributed to official government receipts related to the heavy intervention in exchange markets and loans between central banks in support of this intervention.

Japan's Investment Income, 1986-87

(in millions of dollars*)

	Total	Direct Investment Income	Trade Credit Interest	Loan Interest
Credits				
1986	$29,086	$2,670	$2,180	$2,294
1987	49,162	3,548	2,656	3,132
Debits				
1986	19,613	1,258	131	1,840
1987	32,507	1,544	710	3,099
Net				
1986	9,473	1,412	2,049	454
1987	16,655	2,004	1,946	33

(in millions of yen)

	Total	Direct Investment Income	Trade Credit Interest	Loan Interest
Credits				
1986	Y4,804,135	Y441,004	Y360,071	Y378,900
1987	7,086,211	511,515	438,692	451,540
Debits				
1986	3,239,479	207,784	21,637	303,913
1987	4,685,559	222,552	102,339	446,690
Net				
1986	1,564,655	233,220	338,433	74,987
1987	2,400,652	288,963	336,353	4,850

*The following exchange rates were used to convert the yen figures: 1986, Y165.17 and 1987, Y144.14.

Source: Bank of Japan

Another remarkable feature was the upsurge in the two-way flow of investment income. The total flow of funds in 1987 ($81.7 billion) was 67.7 percent higher than the previous year ($48.7 billion), a sharp departure from the modest annual growth recorded since the start of the decade. It may be a clear sign that the internationalization of the Japanese economy is taking hold.

These statistics give only part of the picture. In fact, since the Bank of Japan presents its balance of payments data in dollars, the yen's appreciation deflates the changes by 14.6 percent when viewed in yen -- 1986's exchange rate was Y165.17=$1.00, while 1987's was Y144.14. If the figures are adjusted for this factor (using 1986's exchange rate to convert 1987 data, for example), the rise in investment income is even more impressive, bringing net receipts to Y2.8 trillion rather than Y2.4 trillion.

Although there is some disagreement in Japan as to whether the record figures represent a permanent change, economists agree that gross flows and net receipts will continue to move upward over the near term. Japan seems to be in a virtuous circle once enjoyed by the United States: increased investment leads to greater income, which again pushes up investment.

Jon Choy

Takeshita's European Trip: Setting The Stage For A Western "Triad"

Prime Minister Noboru Takeshita is progressively debunking the myth that he lacks the interest and experience to conduct a forward-looking foreign policy. In announcing plans for his 11-day European tour, April 29 through May 9, the prime minister promised to unveil an ambitious new economic assistance program as well as sow the seeds for improved relations with Europe. Mr. Takeshita indicated that he hopes to match the close ties that exist between the United States and Japan in economic, cultural, scientific and technological areas, thus forming a Western "triad." This trip, which will include visits to Italy, Britain and West Germany, will be followed by stops in France, Belgium and the Netherlands in June after the United Nations Special Assembly on Disarmament.

In a speech scheduled for May 4 in London, the prime minister is planning to lay out the "Takeshita plan" involving "greater Japanese contributions to the international community." Foreign Ministry press reports said that Mr. Takeshita will announce an increase in aid that will bring Tokyo over the 0.35 percent of gross national product averaged by the 18-member Development Assistance Committee of the Organization for Economic Cooperation and Development. (Japan's 1986 ratio was 0.29 percent.) In an interview prior to the trip, he described this plan as "in the direction" of a grand foreign aid program modeled after the Marshall Plan that rebuilt Europe. This is consistent with recent reports that Tokyo has been pulling together a comprehensive multi-year development assistance policy that will not only feature increased overall expenditures but also improve the quality of its aid.

This speech will come at a critical time in Washington as Congress considers allied defense burden-sharing. Tokyo has maintained that, given its constitutionally proscribed defense role, the aid program is an important and necessary complement to its military buildup. Officials complain that this is not fairly taken into account by U.S. legislators, who charge that Japan is

for the local labor cost allowances and benefits for some 21,000 Japanese employed at the more-than 100 U.S. military facilities in Japan. An estimated Y42 billion ($336 million at Y125=$1.00) is necessary to fund these expenses; Tokyo currently assumes approximately 50 percent of the local labor costs.

Under the U.S.-Japan Mutual Security Treaty, Tokyo is obliged to provide financial support for the operation of U.S. base facilities. Due in part to congressional pressure on Japan to pay more of the defense burden, Japan's fiscal 1988 defense budget includes a Y10 billion ($80 million) increase in host nation support, bringing the total to over Y320 billion ($2.6 billion) overall. This means that Japan will pay as much as $45,000 per U.S. service person annually. Earlier this year, Defense Secretary Frank Carlucci applauded Japan's host nation support program, stating that Japan provides far more than any of the North Atlantic Treaty Organization allies.

Beef And Citrus - Despite five rounds of talks between April 27 and May 3, Agriculture, Forestry and Fisheries Minister Takashi Sato and U.S. Trade Representative Clayton Yeutter failed to come to terms on an arrangement eliminating Japan's import quotas on beef, oranges and orange juice. From the little the two trade negotiators said after the last meeting, the major source of disagreement was Tokyo's plan to impose a variable surcharge on beef imports after the market is open (see JEI Report No. 17B, April 29, 1988). Informed sources said the Reagan administration did not reject the surcharge proposal out of hand but did insist that the extra levy be capped and then gradually reduced. This loss of flexibility was unacceptable to Japan, however.

With the negotiations deadlocked the United States again asked the General Agreement on Tariffs and Trade to form a panel to rule on the legality of Tokyo's beef and citrus quotas. Worried that Washington might retaliate if its request was blocked a second time (see JEI Report No. 15B, April 15, 1988), Japan agreed to this action at GATT's May 4 council meeting. It will take about a month to set up the panel. Japanese trade negotiators would like to continue discussions with their American counterparts in the meantime, but the White House has given no indication whether it is prepared to do this.

Car Exports - Japan's U.S.-bound car shipments during the April 1987-March 1988 period came in 85,851 units below the 2.3 million ceiling -- the first time the industry has failed to fill its quota since shipments were limited seven years ago. While exports by company are not disclosed, analysts assume that Nissan Motor Co., Ltd. accounted for most of the shortfall since month after month of poor sales results for the number-two import seller has led to a huge stock buildup. Going by their U.S. sales and inventory numbers, Mitsubishi Motors Corp., Isuzu Motors, Ltd., Fuji Heavy Industries, Ltd. and Suzuki Motor Co., Ltd. probably did not ship their full allocations either, although their exports were off by no more than 2,000 or 3,000 units each. Mazda Motor Corp. is a closer call. But there is no question that Toyota Motor Corp. and Honda Motor Co., Ltd. filled their quotas since, unlike the competition, both companies are still able to sell every car they send to the United States.

Meanwhile, the Ministry of International Trade and Industry, contrary to early reports (see JEI Report No. 11B, March 18, 1988), has rejuggled company

quotas for the year starting April 1 to allow Daihatsu Motor Co., Ltd. to ship more cars here. The allocation for the newest Japanese marketer was upped from 11,498 units to 17,000 by trimming roughly 0.24 percent off everyone else's allotment (see Table).

Unofficial Quota Allocations, FY 1981-FY 1988

(in units)

Exporter	FY 1981-FY 1983 Quota	FY 1984 Quota	FY 1985-FY 1986 Quota	FY 1987 Quota	FY 1988 Quota
Toyota Motor Corp.	516,659	551,792	616,900	613,816	612,350
Nissan Motor Co., Ltd.	456,030	487,040	544,500	541,778	540,500
Honda Motor Co., Ltd.	348,631	372,338	427,000	424,865	423,850
Mazda Motor Corp.	159,282	173,468	227,800	226,661	226,100
Mitsubishi Motors Corp. (including sales to Chrysler Corp.)	112,584	122,612	195,100	194,125	193,650
Isuzu Motors, Ltd. (including sales to General Motors Corp.)	16,800	49,500	120,400	119,798	119,500
Fuji Heavy Industries, Ltd.	70,014	76,250	107,600	107,062	106,800
Suzuki Motor Co., Ltd. (for sale to General Motors Corp.)	0	17,000	60,700	60,397	60,250
Daihatsu Motor Co., Ltd.	0	0	0	11,498	17,000
Total*	1,680,000	1,850,000	2,300,000	2,300,000	2,300,000

*Not included in these figures are the separate quotas on exports of four-wheel-drive vehicles, station wagons and mini vans and on shipments to Puerto Rico. These quotas are estimated at 112,900 units and 95,700 units, respectively, for the FY 1985-FY 1988 period.

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.